



JENNIFER M. GRANHOLM
GOVERNOR

STATE OF MICHIGAN
DEPARTMENT OF TRANSPORTATION
LANSING

Kirk T. Steudle
DIRECTOR

March 9, 2006

State Transportation Commission
and
Kirk T. Steudle, Director
Michigan Department of Transportation

I am pleased to submit the Annual Financial Report for the Michigan Department of Transportation (MDOT) for the fiscal years ended September 30, 2004 and 2005. This report is prepared by the Bureau of Finance and Administration which is responsible for both the accuracy of the data and the completeness and fairness of the presentation. The data is accurate in all material respects and is presented in a manner designed to fairly set forth the financial position and results of the department's operations.

This report is in compliance with Department of Management and Budget's Administrative Guide to State Government, which requires state agencies issuing financial reports to be consistent with the State of Michigan Comprehensive Annual Financial Report. In complying with state agency reporting guidelines, this report does not fully comply with all generally accepted accounting principles. However, these departures from generally accepted accounting principles are not material; for example, the combined balance sheet does not include long-term obligations or capitalized assets, but all disclosures necessary to enable the reader to gain a reasonable understanding of the department's financial affairs are included. A summary of the department's financial information follows.

FINANCIAL UPDATE

The United States economy grew stronger as gross domestic product increased and unemployment decreased. The State of Michigan's economic recovery continues to lag due to restructuring. As a result of the economy and one time revenues received in FY 2004 for permanent trailer registration fees, transportation revenues decreased in Fiscal Year (FY) 2005. The revenues deposited in the Michigan Transportation Fund (MTF) decreased by \$85.1 million or 4.1 percent in FY 2005. Disbursements from MTF to the State Trunkline Fund, counties and cities/villages decreased 7.7 percent, 4.8 percent and 5.0 percent, respectively.

The Comprehensive Transportation Fund (CTF) received a \$1 million or 0.6 percent increase in MTF revenues for public transportation services. CTF also receives sales tax revenue from vehicle-related sales, which had a substantial decrease of \$8 million or 12.4 percent in FY 2005, due to legislation that redirected \$10 million of sales tax away from CTF. The amount of aviation fuel tax revenue deposited in the Aeronautics Fund decreased by \$1 million or 13.0 percent over the previous fiscal year.

Despite revenue decline, the department effectively managed available revenues by reducing administrative and debt service costs. The department took advantage of recent declines in interest rates and refinanced \$232 million of outstanding State Trunkline Fund (STF) bonds as well as \$65.1 million of outstanding Comprehensive Transportation Fund (CTF) bonds. This resulted in savings of \$12.5 million and \$2.4 million, respectively, for MDOT. The department continues to maintain a strong fiscal plan which supports the five year road and bridge program. MDOT issued new STF bonds totaling \$378 million to pay off \$400 million in GARVEE Notes. The department continues to maintain an AA rating from Standard and Poor's.

In 2005, the authorizations that provided federal transportation dollars were replaced with a new law, Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA:LU). This new act increased the federal gas tax dollars returned to Michigan from 90.5 cents to 92 cents on the dollar. This will result in an increase of approximately \$239 million in federal dollars over the life of this new act. However, SAFETEA:LU also included more earmarked projects than ever before leaving MDOT with less flexible federal dollars. In addition, an increase of \$37 million per year will be provided for transit programs. Several new programs for the safety and security of Michigan's citizens were included in this act including a border infrastructure program, highway safety program and Safe Routes to School program.

PROGRAM OVERVIEW

In FY 2005, MDOT continued the Preserve First Program, which focuses resources on improving the condition of existing roads and bridges. The goal is to have 95 percent of freeway roads and bridges and 85 percent of non-freeway roads and bridges under MDOT's control in good condition by 2007. The advanced use of computer technology continues to enhance accurate forecasting of pavement condition and helps prioritize future projects. Over \$1.1 billion was spent on capital outlay expenditures for roads and bridges in FY 2005.

One of the department's major safety goals is to reduce cross median crashes on freeways by establishing barriers. MDOT is also committed to improving driver safety by upgrading signs and pavement markings for better nighttime visibility, installing rumble strips on road shoulders, and upgrading guardrails.

The department provided over \$168 million for local bus operations including specialized services and transportation to work programs. In addition to operating assistance, \$23.7 million in CTF funds were provided as matching funds for \$141 million in federal funds used for transit infrastructure. Environmental stewardship continues to be a focus of the department with such programs as the MichiVan vanpooling program and providing support for alternative fuel source transit busses. The department also regulates and provides funding for safety enhancements at approximately 5,000 public railroad grade crossings. Funds are provided for railgrade crossing improvement projects and loans and grants for railroad rehabilitation and track construction and extensions for economic development.

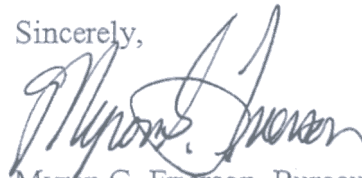
In FY 2005, more than \$164 million was spent to improve air transportation in Michigan, an increase of 19.9 percent over FY 2004. These improvements included grants for capital improvements and equipment that emphasized safety, security and communications, capital grants for airport improvements to infrastructure and runway capacity. Funds also were used to conduct safety seminars, inspect landing sites and airports, register aircraft and dealers and publish and distribute the Michigan Airport Directory and Aeronautical Chart.

CONCLUSION

In FY 2005, \$3.8 billion was expended from all sources to address Michigan's transportation needs. MDOT's challenge continues to be making wise investment decisions with its resources to maximize the results achieved. This has fostered many inventive and innovative ideas at MDOT in the past, and will no doubt promote even more in the future.

I wish to express my appreciation to the many people whose dedicated efforts made possible the preparation of this report. I believe their combined efforts have produced a report that will enable decision makers and concerned citizens to better understand and evaluate the department's financial condition.

Sincerely,

A handwritten signature in blue ink, appearing to read "Myron G. Frierson".

Myron G. Frierson, Bureau Director
Finance and Administration